

State of Hawaii
Department of Hawaiian Home Lands
Financial and Compliance Audit
June 30, 2007

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Department of Hawaiian Home Lands
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June 30, 2007

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PART I

Financial Section



CERTIFIED PUBLIC ACCOUNTANTS

Report of Independent Auditors

Hawaiian Homes Commission
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Hawaiian Home Lands (the "Department"), as of and for the year ended June 30, 2007, which collectively comprise the Department's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the management of the Department. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1 to the financial statements, the financial statements of the Department are intended to present the financial position, and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2007, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Department, as of June 30, 2007, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2008 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis and budgetary comparison information on pages 3 through 10 and 17 through 18, are not required parts of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Department's basic financial statements. The information on the combining balance sheet – nonmajor governmental funds and combining statement of revenues, expenditures and changes in fund balances – nonmajor governmental funds, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining balance sheet – nonmajor governmental funds and combining statement of revenues, expenditures and changes in fund balances – nonmajor governmental funds have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. As described in Note 1 to the schedule of expenditures of federal awards, the accompanying schedule of expenditures of federal awards was prepared on the cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects on the basis of accounting described in Note 1, in relation to the basic financial statements taken as a whole.

Accuity LLP

Honolulu, Hawaii
March 28, 2008

State of Hawaii
Department of Hawaiian Home Lands
Management's Discussion and Analysis
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The following Management's Discussion and Analysis ("MD&A") is designed to provide an overview of the financial performance of the State of Hawaii, Department of Hawaiian Home Lands (the "Department") for the fiscal year ended June 30, 2007. Please read it in conjunction with the Department's financial statements, which follow this section.

Financial Highlights for Fiscal Year 2007

- The Department's total net assets, the amount of assets exceeding liabilities, totaled \$632.0 million. Of this amount, \$230.6 million is unrestricted and \$401.4 million is invested in capital assets, net of related debt.
- The Department's total net assets increased \$47.3 million over the course of this year's operation.
- In fiscal year 2007, the Department's revenues (before transfers) exceeded expenditures by \$17.3 million. In fiscal year 2006, revenues exceeded expenditures by \$2.4 million.
- The total expenditures of the Department increased by \$11.1 million, or 40%.
- The General Fund appropriation was \$302,276 more than fiscal year 2006. This represents a 36% increase in General Fund appropriations.
- The total fund balance of the Department's governmental funds decreased by \$48.2 million, which was largely due to capital outlay for large scale home construction and capital projects.

Overview of the Financial Statements

This MD&A serves as an introduction to the Department's basic financial statements. The basic financial statements are comprised of three components: (1) department-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains other supplementary information (combining financial statements – nonmajor governmental funds) in addition to the basic financial statements.

The first two statements are department-wide financial statements that provide both long-term and short-term information about the Department's overall financial status and operations.

The fund financial statements focus on individual parts of the Department, reporting the Department's status and operations in more detail than the department-wide financial statements. These statements tell how general departmental services were financed in the short-term as well as what remains for future spending.

The statements are followed by a section of required supplementary information that further explains and supports the information in the fund financial statements. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Department-Wide Financial Statements

The department-wide financial statements provide a broad view of the Department's operations. The statements provide both short-term and long-term information about the Department's financial position and activities, which assists in assessing the Department's economic condition at the end of the fiscal year and operations for the year then ended. These statements are prepared using the flow of economic

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resources measurement focus and the accrual basis of accounting. The department-wide financial statements include two statements:

The statement of net assets presents all of the Department's assets and liabilities. The difference between the assets and liabilities are reported as "net assets."

The statement of activities presents information showing how the Department's net assets changed during the fiscal year. This statement presents a comparison between direct expenses and program revenues for each division of the Department.

The activities of the Department are mostly supported by state appropriation, rental income from commercial land leases and intergovernmental revenues. The Department's basic services fall under this type of activity.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Department uses fund accounting to ensure and demonstrate compliance with legal requirements.

The fund financial statements provide more detailed information about the Department's status and operations. Certain of the Department's funds were established under State Law or by bond covenants. Other funds of the Department are established by the Hawaiian Homes Commission. These funds manage money for particular purposes.

The Department only has governmental funds which finance the Department's basic services. Governmental funds are used to account for essentially the same functions reported as governmental activities in the department-wide financial statements. However, unlike the department-wide financial statements, the fund financial statements focus on near-term inflows and outflows of spendable resources as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Department's short-term financing requirements.

Because the focus of fund financial statements is narrower than that of the department-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the department-wide financial statements. By doing so, readers may better understand the long-term impact of the Department's short-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The Department has fourteen governmental funds, seven of which are separately disclosed as major funds for presentation purposes. Each major fund is presented in a separate column in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures and changes in fund balance. These funds are briefly described as follows:

General Fund – The general fund is authorized and appropriated by the State Legislature each year for planning, development, management and general support for Hawaiian Homestead Program.

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Hawaiian Home General Loan Fund – This revolving loan fund was established from a consolidation of all loan funds other than the Hawaiian Home Loan Fund in 1986. The major source of receipts for this fund is through principal repayment. The Department can make loans from the revolving funds for the construction of homes, home repairs or additions, or for the development and operation of a farm, ranch or agriculture operation.

Hawaiian Home Land Trust Fund – This fund was established by Act 14, Special Session 1995 which settles all claims made on behalf of the Hawaiian Home Land Trust against the State between August 21, 1959 and July, 1988. It requires that the State make twenty annual deposits of \$30 million or their discounted equivalent into the Hawaiian Home Land Trust Fund. Proceeds of the fund may be used by the Department for capital improvements and other purposes undertaken in furtherance of the Hawaiian Homes Commission Act of 1920, as amended.

Hawaiian Home Operating Fund – This fund was established through a merger of the Hawaiian Home Development Fund and Hawaiian Home Operating Fund in 1986. Any interest or earnings arising out of investments from the Hawaiian Home Loan Fund are to be credited to and deposited into the Hawaiian Home Operating Fund. All monies received by the Department from any other source, other than those prescribed in other funds of the Hawaiian Homes Commission Act, are deposited into this fund. The Department uses the fund for construction operation and maintenance of revenue-producing activities that are intended to serve principally occupants on Hawaiian Home Lands. The fund is used to finance improvements and developments necessary to serve present and future occupants of Hawaiian Home Lands.

Hawaiian Home Receipts Fund – All interest monies from loans or investments received by the Department from any fund, except the Hawaiian Home Loan Fund, Hawaiian Home Administration Account, Native Hawaiian Rehabilitation Fund, Hawaiian Home Lands Revenue Bond Special Fund and Hawaiian Home Land Trust Fund, are deposited into this fund. This fund serves as a clearing account at the end of each quarter. All monies in this fund are transferred to other funds as authorized by the Hawaiian Homes Commission Act.

Hawaiian Home Administration Account – The revenue sources of this fund are the entire receipts from any leasing or other dispositions of "available lands" and any interest or other earnings arising out of investments from this fund. The Department expends the monies for salaries and all other administrative expenses of the Department, excluding capital improvements, in the absence of general funds appropriated for operating and administrative costs.

Federal Grants – The Department is the recipient of an annual block grant under the Native American Housing and Self-Determination Act ("NAHASDA"). The U.S. Department of Housing and Urban Development is the cognizant entity of the NAHASDA grant in carrying out affordable housing activities for Native Hawaiian families qualified for this program.

The accompanying notes to the financial statements are part of the financial statements. The notes provide additional information that is essential to gain a full understanding of the information provided in the department-wide and fund financial statements.

In addition to the basic financial statements and accompanying notes this report also presents other supplementary information consisting of the combining balance sheet and combining statement of revenues, expenditures and changes in fund balances in connection with nonmajor governmental funds and schedule of expenditures of federal awards.

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Financial Analysis of the Department as a Whole

Net Assets

The Department's total net assets increased by \$47.3 million to approximately \$632.0 million between fiscal year 2007 and 2006, primarily due to the \$30 million annual settlement payment from the State of Hawaii in accordance with Act 14, SP SLH 1995. A large portion of the Department's net assets (63%) reflects its investment in capital assets such as land, buildings, infrastructure and construction-in-progress. The Department uses these capital assets to provide public lands which are leased to Native Hawaiians; consequently, these assets are not available for future spending. Although the Department's investment in its capital assets are reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets cannot be used to liquidate these liabilities.

The following is a comparative statement of net assets:

Summary of Statement of Net Assets
(in millions)

	2007	2006	Increase (Decrease)
Current and other assets	\$ 353.7	\$ 318.6	\$ 35.1
Capital assets	428.7	343.0	85.7
Total assets	<u>\$ 782.4</u>	<u>\$ 661.6</u>	<u>\$ 120.8</u>
Long-term debt outstanding	\$ 25.9	\$ 35.6	\$ (9.7)
Other liabilities	124.5	41.3	83.2
Total liabilities	<u>\$ 150.4</u>	<u>\$ 76.9</u>	<u>\$ 73.5</u>
Net assets			
Invested in capital assets, net of related debt	\$ 401.4	\$ 304.7	\$ 96.7
Unrestricted	230.6	280.0	(49.4)
	<u>\$ 632.0</u>	<u>\$ 584.7</u>	<u>\$ 47.3</u>

Change in Net Assets

The Department's total program revenues increased from \$17.5 million in 2006 to \$52.3 million in 2007 (see statement of activities). Approximately 7.5% of the Department's program revenues came from loan interest income, 17.8% came from interest income on short-term investments, 44.4% came from home sales, and 19.1% came from the general lease program. A portion of the Department's program revenue, approximately 11.3%, came from grants and contributions. Total general revenues decreased by 20.7% to \$33.8 million due to the reclassification of interest from short-term investments. The total cost of the Department's programs increased by \$11.1 million, or 40.1%. The Department received \$30 million as part of the annual settlement payment with the State of Hawaii in accordance with Act 14, SP SLH 1995. Cash was transferred from the Department of Budget and Finance for the Hawaiian Home Lands settlement payment.

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Statement of Activities

The statement of activities presents how the Department's net assets changed during the current fiscal year. Revenues and expenses are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. As such, the statement includes information for some items that will result in cash flows in future fiscal periods (e.g., uncollected lease payments).

The following is a comparative statement of changes in net assets:

	Changes in Net Assets (in millions)		Increase (Decrease)
	2007	2006	
Revenues			
Program revenue			
Administration and support services	\$ 9.3	\$ 8.2	\$ 1.1
Homestead services	3.9	3.3	0.6
Land development	21.3	-	21.3
Home construction/capital projects	1.9	-	1.9
Land management	10.0	10.3	(0.3)
Intergovernmental revenues	5.9	3.9	2.0
Appropriation, net of lapsed appropriations	3.8	3.0	0.8
Other	-	1.4	(1.4)
Total revenues	56.1	30.1	26.0
Expenses			
Administration and support services	8.8	7.5	1.3
Homestead services	17.1	15.4	1.7
Land development	3.8	3.4	0.4
Home construction/capital projects	6.6	-	6.6
Land management	2.5	1.4	1.1
Total expenses	38.8	27.7	11.1
Excess of revenues over expenses	17.3	2.4	14.9
Transfers, net	30.0	30.0	-
Change in net assets	47.3	32.4	14.9
Net assets			
Beginning of year	584.7	552.3	32.4
End of year	\$ 632.0	\$ 584.7	\$ 47.3

As noted, net assets increased \$47.3 million from operations, an 8.1% growth this year. This amount is higher than fiscal 2006 when net assets increased \$32.4 million, a 5.9% growth. Total revenue increased 86.4% over last year, which was largely due to an increase in activities in land development, and expenses increased by 40.1%, primarily due to home construction/capital projects.

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Financial Analysis of the Department's Governmental Funds

Governmental Funds

The focus of the Department's governmental funds is to provide information on short-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Department's financing requirements. In particular, unreserved fund balances may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of fiscal year 2007, the Department's governmental funds reported a combined decrease in fund balance of \$48.2 million. The changes in fund balance for the governmental funds differ from the change in net assets for governmental activities. The differences relate to certain financial resources and expenditures such as debt financing and capital outlays that are included in the changes in fund balances but are not reported in the changes in net assets.

Comparison of Balance Sheet
(in millions)

	Assets			Liabilities			Fund Balances		
	2007	2006	Change	2007	2006	Change	2007	2006	Change
General Fund	\$ 0.1	\$ 0.1	\$ -	\$ -	\$ -	\$ -	\$ 0.1	\$ 0.1	\$ -
General Loan									
Fund	65.0	67.1	(2.1)	9.4	7.3	2.1	55.6	59.8	(4.2)
Trust Fund	180.0	145.6	34.4	80.4	6.7	73.7	99.6	138.9	(39.3)
Federal Grants	24.8	19.8	5.0	23.5	18.5	5.0	1.3	1.3	-
Operating Fund	15.9	18.2	(2.3)	1.3	1.2	0.1	14.6	17.0	(2.4)
Receipts Fund	2.7	2.6	0.1	2.0	2.9	(0.9)	0.7	(0.3)	1.0
Administration									
Account	22.1	15.6	6.5	2.9	1.8	1.1	19.2	13.8	5.4
Other Funds	43.1	49.6	(6.5)	3.5	1.3	2.2	39.6	48.3	(8.7)
Total	\$ 353.7	\$ 318.6	\$ 35.1	\$ 123.0	\$ 39.7	\$ 83.3	\$ 230.7	\$ 278.9	\$ (48.2)

Comparison of Statement of Revenues, Expenditures and
Changes in Fund Balances
(in millions)

	Revenues			Expenditures			Other Financing Sources and Lapsed Appropriations			Net Change in Fund Balance		
	2007	2006	Change	2007	2006	Change	2007	2006	Change	2007	2006	Change
General Fund	\$ 1.2	\$ 0.8	\$ 0.4	\$ 1.0	\$ 0.7	\$ 0.3	\$ (.2)	\$ (.1)	\$ (.1)	\$ -	\$ -	\$ -
General Loan												
Fund	-	-	-	4.2	0.2	4.0	-	-	-	(4.2)	(0.2)	(4.0)
Trust Fund	28.5	5.4	23.1	97.8	32.0	65.8	30.0	30.0	-	(39.3)	3.4	(42.7)
Federal Grants	5.9	3.9	2.0	5.9	2.5	3.4	-	-	-	-	1.4	(1.4)
Operating Fund	0.6	0.5	0.1	9.1	8.2	0.9	6.1	6.4	(0.3)	(2.4)	(1.3)	(1.1)
Receipts Fund	6.7	5.5	1.2	-	-	-	(5.7)	(5.7)	0.0	1.0	(0.2)	1.2
Administration												
Account	10.4	11.1	(0.7)	6.2	6.7	(0.5)	1.2	3.3	(2.1)	5.4	7.7	(2.3)
Other Funds	4.0	3.5	0.5	11.1	2.8	8.3	(1.6)	(3.9)	2.3	(8.7)	(3.2)	(5.5)
Total	\$ 57.3	\$ 30.7	\$ 26.6	\$ 135.3	\$ 53.1	\$ 82.2	\$ 29.8	\$ 30.0	\$ (.2)	\$ (48.2)	\$ 7.6	\$ (55.8)

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At the end of fiscal year 2007, the Hawaiian Home Land Trust Fund reported a decrease in the fund balance of \$39.3 million. The decrease in the fund balance is the result of home construction for our Native Hawaiians. The fund balance of the Hawaiian Home Administration Account increased by \$5.4 million, which was the result of funds being transferred in from the Other Funds and \$4.2 million was the result of operations. Overall, the assets for the Department increased by \$35.1 million, liabilities increased by \$83.3 million, and fund balance decreased by \$48.2 million despite several funds rising in their values and due to the increase in due to State Treasury.

Budgetary Highlights

Actual expenditures in the General Fund were less than budgetary estimates by \$196,753 or 17.1%. The favorable variance was created by expenditure control measures.

In the Hawaiian Home Administration Account, the actual revenue exceeded the budgeted amount by \$1.9 million and expenditures were \$2.0 million less than the budgeted amount. The favorable variances were created by increased general lease collections and spending cuts.

Capital Asset and Debt Administration

Capital Assets

At the end of fiscal year 2007, the Department had invested \$533.5 million in a broad range of capital assets, including land, building, improvements, equipment and infrastructure. This amount represents a net increase (including additions, deductions and reclassifications) of \$91.2 million, or 20.6%, over last year.

Capital Assets (in millions)			
	2007	2006	Increase (Decrease)
Buildings and improvements	\$ 11.9	\$ 10.4	\$ 1.5
Furniture and equipment	1.6	0.5	1.1
Motor vehicles	0.8	0.8	-
Infrastructure	306.0	304.5	1.5
Total depreciable assets	320.3	316.2	4.1
Less: accumulated depreciation	(104.8)	(99.3)	(5.5)
Net depreciable assets	215.5	216.9	(1.4)
Land	40.0	40.0	-
Construction in progress	173.2	86.1	87.1
Total capital assets	<u>\$ 428.7</u>	<u>\$ 343.0</u>	<u>\$ 85.7</u>

In fiscal year 2007, the Department expended \$99.7 million for various capital projects. The Department has no plan to issue additional debt to finance the infrastructure construction projects. The Department will continue to use its trust funds and federal funds to fund these projects.

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Long-Term Debt

In October 2006, the Department paid off its outstanding revenue bonds. The Department is also obligated to repay a portion of the State general obligation bonds issued on the Department's behalf through reimbursable general obligation bonds. The total obligation is \$0.9 million and will be paid in full through fiscal year 2018.

Outstanding Debt (in millions)			
	2007	2006	Increase (Decrease)
Revenue bonds	\$ -	\$ 8.7	\$ (8.7)
General obligation bonds	0.9	1.1	(0.2)
Total	<u>\$ 0.9</u>	<u>\$ 9.8</u>	<u>\$ (8.9)</u>

Economic Factors and Next Year's Budgets

In the 2007–2008 budget, the general fund appropriation is \$1.2 million and reflects an increase of \$0.1 million, or an 9.1% from fiscal year 2007.

Revenues generated from general leases, revocable permits, licenses and right of entry agreements are projected to total \$10.4 million. This represents an 11.8% increase from the prior fiscal year projection. The increase is primarily due to new general lease dispositions and general lease rental re-openings.

Currently Known Facts or Decisions

The Department has revised its strategic plan which now covers the time period between 2007–2011. The Department now has 5 goals: deliver 1,000 homestead awards annually to the beneficiaries, provide beneficiaries with the necessary tools for long-term homeownership, improve overall operational efficiency and delivery of services to our beneficiaries, attain financial self-sufficiency, and effectively manage and protect the trust.

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Statement of Net Assets
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Assets

Cash and short-term investments held in State Treasury	\$ 239,095,787
Cash and short-term investments held outside of State Treasury	1,153,320
Investments	21,836,900
Receivables	
Due from State	3,937,176
Loans, net of allowance for losses of \$8,641,384	49,363,135
Accrued interest	4,410,344
General leases and licenses, net of allowance for losses of \$893,000	474,337
Other	1,088,287
Inventory of homes for sale	30,739,084
Other assets	1,630,868
Capital assets, net	428,706,263
Total assets	<u>\$ 782,435,501</u>

Liabilities

Vouchers and contracts payable	\$ 23,266,086
Accrued wages and employee benefits payable	663,892
Due to State Treasury	58,684,162
Advances of Federal grant funds	22,990,221
Other liabilities	13,561,757
Deferred revenue	2,421,357
Purchase note payable	
Due within one year	2,200,000
Due in more than one year	24,200,000
Bonds payable	
Due within one year	186,000
Due in more than one year	679,735
Accrued vacation	
Due within one year	468,770
Due in more than one year	1,029,376
Total liabilities	<u>150,351,356</u>

Commitments and contingencies

Net Assets

Invested in capital assets, net of related debt	401,440,528
Unrestricted	230,643,617
Total net assets	<u>632,084,145</u>
Total liabilities and net assets	<u>\$ 782,435,501</u>

The accompanying notes are an integral part of the financial statements.

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Statement of Activities
Year Ended June 30, 2007

Functions/Programs	Program Expenses	Program Revenue		Net (Expense) Revenue and Changes in Net Assets
		Interest, Rent and Fees	Operating Grants and Contributions	
Administration and support services	\$ 8,767,508	\$ 9,338,933	\$ 2,529,835	\$ 3,101,260
Homestead services	17,066,191	3,901,289	13,045	(13,151,857)
Land development	3,784,481	21,320,841	3,392,584	20,928,944
Home construction/capital projects	6,621,441	1,872,081	-	(4,749,360)
Land management	2,510,682	9,979,493	5,000	7,473,811
Total governmental activities	\$ 38,750,303	\$ 46,412,637	\$ 5,940,464	13,602,798
General revenues				
State appropriations, net of lapsed appropriations of \$193,959				3,761,156
Transfers, net				30,000,000
Total general revenues and transfers				33,761,156
Change in net assets				47,363,954
Net assets at July 1, 2006				584,720,191
Net assets at June 30, 2007				\$ 632,084,145

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Balance Sheet
Governmental Funds
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	General Fund	Hawaiian Home General Fund	Hawaiian Home Land Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	Other Funds	Total
Assets									
Cash and short-term investments held in State Treasury	\$ 86,295	\$ 18,017,025	\$ 147,953,830	\$ 15,866,550	\$ 2,509	\$ 21,418,021	\$ 27,986	\$ 35,723,571	\$ 239,095,787
Cash and short-term investments held outside of State Treasury	-	-	-	-	-	-	1,153,320	-	1,153,320
Investments	-	-	-	-	-	-	21,836,900	-	21,836,900
Receivables	-	-	-	-	-	-	-	3,937,176	3,937,176
Due from State	-	-	-	-	-	-	-	-	-
Loans, net of allowance for losses of \$8,641,384	-	44,864,619	-	-	-	-	1,408,206	3,090,310	49,363,135
Accrued interest	-	-	1,308,936	26,932	2,703,225	187,746	3,194	180,311	4,410,344
General leases and licenses, net of allowance for losses of \$893,000	-	-	-	10,740	-	463,597	-	-	474,337
Other	-	610,558	-	48,152	-	-	429,577	-	1,088,287
Inventory of homes for sale	-	-	30,739,084	-	-	-	-	-	30,739,084
Other assets	-	1,503,870	-	-	-	-	-	126,998	1,630,868
Total assets	\$ 86,295	\$ 64,996,072	\$ 180,001,850	\$ 15,952,374	\$ 2,705,734	\$ 22,069,364	\$ 24,859,183	\$ 43,058,366	\$ 353,729,238
Liabilities									
Vouchers and contracts payable	\$ -	\$ -	\$ 21,703,018	\$ 479,730	\$ -	\$ 222,666	\$ 534,157	\$ 326,495	\$ 23,266,086
Accrued wages and employee benefits payable	25,124	-	-	352,938	-	285,830	-	-	663,892
Due to State Treasury	5,000	-	58,679,162	-	-	-	-	-	58,684,162
Advances of Federal grant funds	-	-	-	-	-	-	22,990,221	-	22,990,221
Other liabilities	-	9,442,799	-	119,440	857,723	-	-	3,141,795	13,561,757
Deferred revenue	-	-	-	381,233	1,144,600	2,381,524	-	-	3,907,357
Total liabilities	30,124	9,442,799	80,382,180	1,333,341	2,002,323	2,890,040	23,524,378	3,468,290	123,073,475
Commitments and contingencies									
Fund Balances									
Reserved for									
Encumbrances	76,020	-	129,990,876	6,500,358	-	662,069	-	3,379,695	140,609,018
Receivables	-	44,864,619	-	-	-	-	1,840,977	3,184,462	49,890,058
Loan commitments	-	1,151,995	-	-	-	-	-	-	1,151,995
Unexpended Federal grants	-	-	-	-	-	-	13,175,705	-	13,175,705
Guaranteed and insured loans	-	150,000	-	-	-	-	-	10,850,100	11,000,100
Total reserved fund balances	76,020	46,166,614	129,990,876	6,500,358	-	662,069	15,016,682	17,414,257	215,826,876
Unreserved	(19,849)	9,386,659	(30,371,206)	8,118,675	703,411	18,517,255	(13,681,877)	-	(7,346,932)
Unreserved, reported in nonmajor Special revenue funds	-	-	-	-	-	-	-	19,675,818	19,675,818
Construction funds	-	-	-	-	-	-	-	2,500,001	2,500,001
Total unreserved fund balance	(19,849)	9,386,659	(30,371,206)	8,118,675	703,411	18,517,255	(13,681,877)	22,175,819	14,828,887
Total fund balances	56,171	55,553,273	99,619,670	14,619,033	703,411	19,179,324	1,334,805	39,590,076	230,655,763
Total liabilities and fund balances	\$ 86,295	\$ 64,996,072	\$ 180,001,850	\$ 15,952,374	\$ 2,705,734	\$ 22,069,364	\$ 24,859,183	\$ 43,058,366	\$ 353,729,238

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Assets
June 30, 2007

Total fund balances – governmental funds \$ 230,655,763

Amounts reported for governmental activities in the statement of net assets
are different because

Capital assets used in governmental activities are not financial resources
and therefore are not reported in the funds. These assets consists of:

Infrastructure assets	\$ 305,972,092	
Construction-in-progress	173,191,366	
Land	40,004,470	
Other capital assets	14,310,182	
Accumulated depreciation	<u>(104,771,847)</u>	
		428,706,263

Other assets are not available to pay for current-period expenditures and
therefore, are deferred, or not recognized, in the funds. 1,486,000

Long-term liabilities are not due and payable in the current period and
therefore are not reported in the funds, including:

Purchase note payable	(26,400,000)	
Bonds payable	(865,735)	
Accrued vacation	<u>(1,498,146)</u>	
Net assets of governmental entities		<u>\$ 632,084,145</u>

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
Year Ended June 30, 2007

	General Fund	Hawaiian Home General Fund	Hawaiian Home Land Trust Fund	Hawaiian Home Operating Fund	Hawaiian Home Receipts Fund	Hawaiian Home Administration Account	Federal Grants	Other Funds	Total
Revenues									
State appropriations	\$ 1,150,799	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,804,316	\$ 3,955,115
General leases	-	-	-	-	-	6,729,249	-	-	6,729,249
Licenses and permits	-	-	-	-	-	2,885,849	-	-	2,885,849
Interest from loans and note receivable	-	-	-	75,921	4,486,418	-	-	-	4,562,339
Interest from short-term investments	-	-	-	45,281	2,209,800	-	-	-	9,322,521
Intergovernmental revenues	-	-	-	(218)	-	791,726	-	958,834	5,940,464
Real property sold	-	-	-	-	-	-	5,940,682	-	21,320,841
Other	-	-	-	459,522	-	14,883	951	-	2,586,838
Total revenues	1,150,799	-	28,485,643	580,506	6,696,218	10,421,707	5,941,633	4,026,710	57,303,216
Expenditures									
Current									
Administration and support services	442,041	-	51,114	3,342,727	-	2,991,637	296,344	1,137,514	8,261,377
Homestead services	381,800	4,261,593	-	1,822,918	-	1,904,901	74,000	33,141	8,478,353
Land development	78,469	-	1,794,073	694,447	-	819,341	361,529	33,119	3,780,978
Land management	54,514	-	256,105	697,141	-	493,417	-	980,404	2,481,561
Capital outlay	-	-	95,626,070	2,229,954	-	-	5,248,362	-	103,104,386
Debt service	-	-	-	197,627	-	-	-	8,650,000	8,847,627
Principal	-	-	-	40,633	-	-	-	320,614	361,247
Interest	-	-	-	-	-	-	-	-	-
Total expenditures	956,824	4,261,593	97,727,362	9,025,447	-	6,209,296	5,980,235	11,154,792	135,315,549
Excess (deficiency) of revenues over (under) expenditures	193,975	(4,261,593)	(69,241,719)	(8,444,941)	6,696,218	4,212,411	(38,602)	(7,128,082)	(78,012,333)
Other financing sources (uses)	-	-	30,000,000	9,880,532	-	11,380,789	103,090	2,923,307	54,287,718
Transfers in	-	-	-	(3,750,000)	(5,758,321)	(10,175,807)	(103,090)	(4,500,500)	(24,287,718)
Transfers out	-	-	-	-	-	-	-	-	-
Total other financing sources (uses)	-	-	30,000,000	6,130,532	(5,758,321)	1,204,982	-	(1,577,193)	30,000,000
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	193,975	(4,261,593)	(39,241,719)	(2,314,409)	937,897	5,417,393	(38,602)	(8,705,275)	(48,012,333)
Lapsed appropriations	(193,959)	-	-	-	-	-	-	-	(193,959)
Net change in fund balances	16	(4,261,593)	(39,241,719)	(2,314,409)	937,897	5,417,393	(38,602)	(8,705,275)	(48,206,292)
Fund balances at July 1, 2006	56,155	59,814,866	138,861,389	16,933,442	(234,486)	13,761,931	1,373,407	48,295,351	278,862,055
Fund balances at June 30, 2007	\$ 56,171	\$ 55,553,273	\$ 99,619,670	\$ 14,619,033	\$ 703,411	\$ 19,179,324	\$ 1,334,805	\$ 39,590,076	\$ 230,655,763

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Reconciliation of the Governmental Funds Statement of Revenues,
Expenditures and Changes in Fund Balances to the Statement of Activities
Year Ended June 30, 2007

Net change in fund balances – governmental funds	\$ (48,206,292)
Amounts reported for governmental activities in the statement of activities are different because:	
Capital outlays are reported as expenditures in governmental funds, however in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these outlays are:	
Capital outlay	\$ 99,715,423
Depreciation expense	(9,027,383)
Loss on disposal	<u>(5,009,412)</u>
Excess of capital outlay over depreciation expense and loss on disposal	85,678,628
Payment of note payable is reported as an expenditure in governmental funds, but the payment reduces note payable in the statement of net assets.	2,200,000
Repayment of bond principal is reported as an expenditure in governmental funds, but the repayment reduces bonds payable in the statement of net assets.	8,847,627
The net increase in accrued vacation is reported in the statement of activities and does not require the use of current financial resources and therefore is not reported as expenditures in governmental funds.	(161,009)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues and are deferred in the governmental funds.	<u>(995,000)</u>
Change in net assets of governmental activities	<u>\$ 47,363,954</u>

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis)
General Fund
Year Ended June 30, 2007

	Budgeted Amounts		Actual	Variance
	Original	Final	(Budgetary Basis)	Over (Under)
State appropriations	<u>\$ 1,067,559</u>	<u>\$ 1,150,525</u>	<u>\$ 1,150,799</u>	<u>\$ 274</u>
Expenditures				
Administration and support services	465,768	486,298	441,467	44,831
Homestead services	493,233	544,406	379,675	164,731
Land development	50,353	55,577	78,281	(22,704)
Land management	<u>58,205</u>	<u>64,244</u>	<u>54,349</u>	<u>9,895</u>
Total expenditures	<u>1,067,559</u>	<u>1,150,525</u>	<u>953,772</u>	<u>196,753</u>
Excess of revenues over expenditures	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 197,027</u>	<u>\$ 197,027</u>

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Statement of Revenues and Expenditures – Budget and Actual (Budgetary Basis)
Other Major Funds
Year Ended June 30, 2007

	Budgeted Amounts		Actual	Variance
	Original	Final	(Budgetary Basis)	Over (Under)
Hawaiian Home Administration Account				
Revenues	\$ 8,312,279	\$ 8,567,809	\$ 10,421,707	\$ 1,853,898
Expenditures				
Administration and support services	3,672,486	3,753,425	3,135,062	618,363
Homestead services	2,539,686	2,631,899	2,137,179	494,720
Land development	1,268,262	1,320,273	805,223	515,050
Land management	831,845	862,212	477,195	385,017
Total expenditures	8,312,279	8,567,809	6,554,659	2,013,150
Excess of revenues over expenditures	\$ -	\$ -	\$ 3,867,048	\$ 3,867,048

The accompanying notes are an integral part of the financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2007

1. Organization and Summary of Significant Accounting Policies

Financial Reporting Entity

The State of Hawaii, Department of Hawaiian Home Lands (the "Department"), is headed by the Hawaiian Homes Commission. The Department was established by Section 24, of Act 1 (the Hawaii State Government Reorganization Act of 1959), Second Special Session Laws of Hawaii 1959, and is responsible for the administration of the Hawaiian Homes Commission Act of 1920 enacted by the United States Congress. The Hawaiian Homes Commission Act ("HHCA") sets aside certain public lands as Hawaiian Home Lands to be utilized in the rehabilitation of native Hawaiians. The financial statements include the public trusts controlled by the Hawaiian Homes Commission.

The Department is part of the executive branch of the State of Hawaii (the "State"). The Department's financial statements are intended to present the financial position and the changes in financial position, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State that is attributable to the transactions of the Department. The State Comptroller maintains the central accounts for all State funds and publishes financial statements for the State annually which includes the Department's assets, liabilities, net assets and financial activities.

The accompanying financial statements of the Department have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") for state and local governments as prescribed by the Governmental Accounting Standards Board ("GASB").

Department-wide Financial Statements

The department-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function.

Appropriations and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than as program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or are imposed by constitutional provisions or enabling legislation. At June 30, 2007, there were no restricted net assets.

State of Hawaii
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2007

Governmental Fund Financial Statements

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Department considers revenues to be available if they are collected within 60 days of the end of the current fiscal year end. Principal revenue sources considered susceptible to accrual include lease payments, sales, federal grants and interest on loans and investments, and interest receivable. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditure, as well as expenditures related to compensated absences are recorded only when payment is due.

Internally imposed designations of resources are presented as reserves of fund balances. Portions of fund balances are reserved for the following:

- *Encumbrances* – recorded obligations in the form of purchase orders or contracts.
- *Receivables* – amounts owed to the Department at year end and are shown as reserved to indicate that a portion of the fund balance is not available for funding current expenditures.
- *Loan commitments* – loans approved before year end but funded after year end.
- *Unexpended federal grants* – encumbrances of federal awards not yet received from the federal government.
- *Guaranteed and insured loans* – amounts designated to pay mortgage guarantees and insurance claims.

Unreserved fund balances represents resources that have not been internally designated.

Fund Accounting

The accounts of the Department are organized on the basis of funds, each of which is considered a separate accounting entity. The financial activities of each fund are accounted for with a separate set of self-balancing accounts which represent each fund's assets, liabilities, fund equity, revenues and expenditures.

The financial activities of the Department that are reported in the accompanying governmental fund financial statements have been classified into the following major governmental funds:

General fund – The general fund is used to account for all financial resources except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted for.

State of Hawaii
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2007

Special revenue funds – Special revenue funds are used to account for proceeds of specific revenue sources that are restricted to expenditures for specified purposes. Revenues are primarily from general leases, licenses and permits granted for commercial, residential, agricultural and pastoral uses, and interest and investment income. The Department's major special revenue funds are as follows:

- *Hawaiian Home General Loan Fund* – The Hawaiian Home General Loan Fund is used to account for Department loans made to native Hawaiian homesteaders.
- *Hawaiian Home Land Trust Fund* – The Hawaiian Home Land Trust Fund accounts for funds from the State to be expended by the Department, as provided by law upon approval by the Commission and used for capital improvements and other purposes undertaken in furtherance of the Hawaiian Homes Commission Act of 1920.
- *Hawaiian Home Operating Fund* – The Hawaiian Home Operating Fund is used to account for operations of the Department and is funded by monies transferred from the Hawaiian Home Receipts Fund.
- *Hawaiian Home Receipts Fund* – The Hawaiian Home Receipts Fund is used to account for receipts of investment interest and loan interest payments from the Department loans to homesteaders.
- *Hawaiian Home Administration Account* – The Hawaiian Home Administration Account is used to account for commercial general leases, revocable permits and licenses of homestead lands. Lease revenues are used to fund operations of the Department.
- *Federal Grants* – The Federal Grants fund is used to account for grants the Department has with the Federal Government.

Appropriations

An authorization granted by the State Legislature permitting a State agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year, except for allotted appropriations related to capital projects.

Encumbrances

Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is employed as an extension of formal budgetary integration in the governmental fund types. Encumbrances outstanding at fiscal year end are reported as reservations of fund balances, since they do not constitute expenditures or liabilities.

Cash and Short-term Investments

The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Effective August 1, 1999, cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

State of Hawaii
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2007

The State requires that depository banks pledge as collateral, government securities held in the name of the State for deposits not covered by federal deposit insurance.

GASB Statement No. 40, *Deposit and Investment Risk Disclosures* ("Statement No. 40") requires disclosures over common deposit and investment risks related to credit risk, interest rate risk, and foreign currency risk. Investments can be categorized by type, maturity and custodian to determine the level of interest rate, credit and custodial risk assumed by the Department. However, as all of the Department's monies are held in the State cash pool, the Department does not manage its own investments and the types of investments and related interest rate, credit, and custodial risks are not determinable at the Department level. The risk disclosures of the State's cash pool are included in the State's Comprehensive Annual Financial Report ("CAFR") for the fiscal year ended June 30, 2007 which may be obtained from the following address:

Department of Accounting and General Services
Accounting Division
P.O. Box 119
Honolulu, Hawaii 96810-0119

Cash and short-term investments held outside of State Treasury are held in a financial institution in the State of Hawaii. At June 30, 2007, the depository bank had pledged investment securities with an approximate aggregate market value of \$9,886,000 as collateral on certain of these deposits.

Due from State

The State Director of Finance is responsible for the safekeeping of all cash in the State Treasury in accordance with State laws. Currently, separate accounts are not maintained in the State Treasury for the Department's general operating and capital appropriations. Although these appropriations are available to the Department to expend, custody and ownership of the funds remains with the State. Unspent general and capital appropriations that continue to be available to the Department for expenditure at the end of the fiscal year are reported as due from state in the accompanying fund and department-wide financial statements.

Investments

The Department invests advances received from the Native Hawaiian Housing Block Grant in obligations of the U.S. Government. The investments are carried at fair value and are valued at the last reported sale price on the last business day of the year or at the last bid price if no sale was reported on that date. Unrealized gains and losses are considered grant program income and must be used in the Native Hawaiian Housing Grant Program and is therefore recorded as advances from Federal Grants.

Inventory of Homes for Sale

Inventory of homes for sale are stated at the lower of cost or estimated net realizable value and includes the costs of land development and home construction, capitalized interest, real estate taxes, and direct overhead costs incurred during development and home construction.

Intrafund and Interfund Transactions

Significant transfers of financial resources between activities and appropriations included within the same fund are eliminated. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the financial statements.

All interfund transfers are reflected in the governmental fund financial statements but are eliminated in the departmental financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2007

Capital Assets

Capital assets, which include land, buildings, improvements, equipment and infrastructure assets, are reported in the departmental financial statements. The capitalization thresholds are \$5,000 for equipment, and \$100,000 for infrastructure, and buildings and improvements with estimated useful lives of greater than one year. Maintenance and repairs are charged to operations when incurred. Purchased and constructed capital assets are valued at historical cost or estimated historical cost. Donated fixed assets are recorded at their fair market value at the date of donation.

Capital assets are depreciated on the straight-line method over the assets' estimated useful life. Generally, estimated useful lives are as follows:

Machinery and equipment	5 – 7 years
Vehicles	5 years
Buildings and improvements	15 – 40 years
Infrastructure	30 years

A portion of the Department's monthly base rent is paid by the Department of Accounting and General Services, State of Hawaii.

The Department also has land in various parts of the State, some of which were transferred to it at no cost or at nominal cost.

Accumulated Vacation and Sick Leave

Vacation pay is accrued as earned by employees. Vacation pay can accumulate at the rate of one and three-quarters working days for each month of service up to 720 hours at calendar year-end and is convertible to pay upon termination of employment. As accrued vacation does not require the use of current financial resources, it is not reported in the governmental funds balance sheet.

Sick leave accumulates at a rate of one and three-quarter days for each month of service without limit, but may be taken only in the event of illness or other incapacitation and is not convertible to pay upon termination of employment. Accordingly, accumulated sick leave is not included in the Department's statement of net assets or governmental fund balance sheet. However, an employee who retires or leaves government service in good standing with sixty days or more in unused sick leave is entitled to additional service credit in the Employees' Retirement System of the State of Hawaii ("ERS"). Accumulated sick leave as of June 30, 2007, was approximately \$4,343,000.

General Leases and Licenses

General leases and licenses received in advance are recognized on a straight-line basis over the lease or license term.

Lease Rents and Interest Income

The Department's governmental fund financial statement recognizes lease rent and mortgage interest of its governmental funds as revenues when they are measurable and available. The available criterion is satisfied when revenues are collectible during the period or soon enough thereafter to pay liabilities of the current period. Amounts not collected within 60 days after the end of the year approximated \$1,486,000 as of June 30, 2007, and are recorded as deferred revenue. The departmental financial statements present lease rents and mortgage interest under the accrual method of accounting.

State of Hawaii
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2007

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

New Accounting Pronouncements

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition and display of other postretirement benefits expense/expenditures and related liabilities (assets), note disclosures and required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2006. Management has not yet determined the effect this Statement will have on its financial statements.

In June 2005, the GASB issued Statement No. 47, *Accounting for Termination Benefits*. This Statement establishes standards for accounting for termination benefits that affect an employer's obligations. For defined benefit other postemployment benefit plans, the provisions of this Statement are effective for the fiscal year beginning after December 15, 2006. For all other termination benefits, the provisions of this Statement are effective in fiscal 2007. Management does not expect this Statement to have a material effect on the Department's financial statements.

In May 2007, the GASB issued Statement No. 50, *Pension Disclosures – An Amendment of GASB Statements No. 25 and 27*. This Statement is to amend note disclosure and required supplementary information ("RSI") standards of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, to conform with applicable changes adopted in Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The provisions of this Statement are effective for periods beginning after June 15, 2007, except for requirements related to the use of the entry age actuarial cost method for the purpose of reporting a surrogate funded status and funding progress of plans that use the aggregate actuarial cost method, which are effective for periods for which the financial statements and RSI contain information resulting from actuarial valuations as of June 15, 2007, or later. Management has not yet determined the effect this Statement will have on the Department's financial statements.

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. The provisions of this Statement establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies, thereby enhancing the comparability of the accounting and financial reporting of such assets among state and local governments. This Statement also results in a more faithful representation of the service capacity of intangible assets – and therefore the financial position of governments – and of the periodic cost associated with the usage of such service capacity in governmental financial statements. The provisions of this Statement are effective for periods beginning after June 15, 2009. Management does not expect this Statement to have a material effect on the Department's financial statements.

State of Hawaii
Department of Hawaiian Home Lands
Notes to Financial Statements
June 30, 2007

In November 2007, the GASB issued Statement No. 52, *Land and Other Real Estate Held As Investments by Endowments*, effective for the Department's fiscal year beginning July 1, 2008. Statement No. 52 requires that land and other real estate held as investments by endowments be reported at fair value at the reporting date. Changes in fair value during the period should be reported as investment income. Management has not yet determined the effect this Statement will have on the Department's financial statements.

2. Budgeting and Budgetary Control

The Department's annual budget is prepared on the cash basis utilizing encumbrance accounting. Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated throughout the fiscal year. Amounts reflected by the Department as budgeted revenues are those estimates as compiled by the State Director of Finance. Budgeted expenditures for the Department's general fund, and the Hawaiian Homes Administration Account, a special revenue fund, are provided to the Department of Budget and Finance, State of Hawaii, for accumulation with budgeted amounts of the other State agencies and included in the Governor's executive budget that is subject to legislative approval. In addition, the budget for all expenditures of the Department's funds is also presented annually to the Hawaiian Homes Commission for approval.

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions which may terminate the authorization for other appropriations.

For purposes of budgeting, the Department's budgetary fund structure and accounting principles differ from those utilized to present the financial statements in conformity with accounting principles generally accepted in the United States of America. Since the budgetary basis differs from accounting principles generally accepted in the United States of America, budget and actual amounts in the statement of revenues and expenditures – budget and actual – general fund, are presented on the budgetary basis. A reconciliation of general fund revenues in excess of expenditures on a budgetary basis for the year ended June 30, 2007, to general fund revenues in excess of expenditures presented in conformity with accounting principles generally accepted in the United States of America, is set forth below.

Under Section 78-13 Hawaii Revised Statutes ("HRS"), staff salaries and wages amounting to approximately \$31,000 and \$286,000 in the general fund and Hawaiian Home Administration Account, respectively, for the period from June 16, 2007 through June 30, 2007, are to be funded with monies budgeted for fiscal year 2008. Accordingly, these amounts are excluded from the statements of revenues and expenditures – budget and actual of the general fund and Hawaiian Home Administration Account, but are included in the departmental and governmental fund financial statements in accordance with accounting principles generally accepted in the United States of America.

Salaries and wages amounting to approximately \$28,000 and \$295,000 in the general fund and Hawaiian Home Administration Account, respectively, for the period from June 16, 2006 to June 30, 2006, were funded with monies budgeted for fiscal year 2007. Accordingly, these amounts are included in the statements of revenues and expenditures – budget and actual of the general fund and Hawaiian Home Administration Account, for the year ended June 30, 2007.

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The following schedule reconciles the budgetary amounts of the general fund and the Hawaiian Home Administration Account to the amounts presented in accordance with accounting principles generally accepted in the United States of America (GAAP basis).

	General Fund	Hawaiian Home Administration Account
Excess of revenues over expenditures – actual on budgetary basis	\$ 197,027	\$ 3,867,048
Current year's appropriations included in reserved for encumbrances at June 30, 2007	-	289,072
Expenditures for liquidation of prior year's encumbrances	-	(59,843)
Reverse allowance for losses adjustment	-	107,000
Fiscal 2006 expenditures funded by fiscal 2007 budget	28,069	295,123
Fiscal 2007 expenditures funded by fiscal 2008 budget under Section 78-13 HRS	<u>(31,121)</u>	<u>(285,989)</u>
Excess of revenues over expenditures – GAAP basis	<u>\$ 193,975</u>	<u>\$ 4,212,411</u>

3. Cash and Short-Term Investments

Cash and short-term investments includes monies in the State Treasury. For financial statement reporting purposes, cash and short-term investments consist of cash, time certificates of deposit, and money market accounts. Cash and short-term investments also include repurchase agreements and U.S. government securities with original maturities of three months or less.

As of June 30, 2007, the carrying amount, which approximates the bank balance, of the Department's cash and short-term investments was \$239,095,787.

The Department invests advances from the Native Hawaiian Housing Block Grant in cash, short-term investments, and obligations of the U.S. government held outside of the State Treasury through a financial institution in the State of Hawaii. At June 30, 2007, the carrying amount and bank balances of the Department's cash and short-term investments outside of the State Treasury aggregated \$1,153,320.

Investments in obligations of the U.S. government mature at various dates through fiscal 2008. At June 30, 2007, the securities had an original cost of \$21,684,301, fair value of \$21,836,900 and a net unrealized gain of \$152,599. Income from the investments is considered grant program income and must be used in the Native Hawaiian Housing Program and is therefore recorded as amounts due to other governments.

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4. Loans Receivable

Loans receivable consist of approximately 1,400 loans made to native Hawaiian lessees for the purposes specified in the Hawaiian Homes Commission Act. Loans are for a maximum amount of approximately \$235,000 and for a maximum term of 30 years. Interest rates on outstanding loans range from 2.5% to 10.0%. The Department's loan portfolio consists of loans that the Department has originated and that generally are collateralized by improvements on the leased properties located in the State. Loan commitments as of June 30, 2007 were \$1,151,995. The Department has provided an allowance for loan losses of approximately \$8,641,000 as of June 30, 2007. The allowance for loan losses is a valuation reserve, which has been provided through charges to operations. The reserve is based on management's assessment of loan balances deemed uncollectible as of June 30, 2007.

5. Inventory of Homes for Sale

The Department is constructing a total of 326 homes for sale to native Hawaiians in the Kaupē'a, Village of Kapolei subdivision on the island of Oahu. As of June 30, 2007, 91 homes were completed or sold while the Department had accumulated \$30,739,084 of costs toward the construction of the remaining homes.

Under certain circumstances, the Department purchases homes from former lessees due to voluntary and involuntary cancellations of land leases. The homes are subsequently resold to qualified lessees. During the year ended June 30, 2007, the Department had purchased homes from former lessees with costs aggregating \$1,447,000.

6. Capital Assets

Capital assets activity for the year ended June 30, 2007, was as follows:

	Balance July 1, 2006	Additions	Disposals	Balance June 30, 2007
Capital assets, not being depreciated				
Land	\$ 40,004,470	\$ -	\$ -	\$ 40,004,470
Construction in progress	86,114,551	94,282,945	(7,206,130)	173,191,366
Total capital assets, not being depreciated	126,119,021	94,282,945	(7,206,130)	213,195,836
Capital assets, being depreciated				
Buildings and improvements	10,446,367	1,530,662	(72,000)	11,905,029
Infrastructure	304,469,336	9,783,268	(8,280,512)	305,972,092
Furniture and equipment	477,161	1,299,678	(187,221)	1,589,618
Motor vehicles	841,199	25,000	(50,664)	815,535
Total capital assets, being depreciated	316,234,063	12,638,608	(8,590,397)	320,282,274
Less: Accumulated depreciation for				
Buildings and improvements	(3,730,291)	(341,917)	-	(4,072,208)
Infrastructure	(94,550,761)	(7,479,837)	3,541,212	(98,489,386)
Furniture and equipment	(411,168)	(1,144,765)	13,861	(1,542,072)
Motor vehicles	(633,229)	(60,864)	25,912	(668,181)
Total accumulated depreciation	(99,325,449)	(9,027,383)	3,580,985	(104,771,847)
Total capital assets, being depreciated, net	216,908,614	3,611,225	(5,009,412)	215,510,427
Capital assets, net	\$ 343,027,635	\$ 97,894,170	\$ (12,215,542)	\$ 428,706,263

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Depreciation expense for the year ended June 30, 2007, were charged to functions of the Department as follows:

Administration and support services	\$ 1,545,122
Homestead services	7,481,101
Land development	<u>1,160</u>
Total depreciation	<u>\$ 9,027,383</u>

7. Due to State Treasury

In October 2006, the Department received a temporary, non-interest bearing loan from the State of Hawaii in the amount of \$80,000,000, pursuant to HRS Section 36-24. The loan funds will be used for home construction. At June 30, 2007, the balance of the temporary loan in the Hawaiian Home Land Trust Fund was \$58,679,162 and was subsequently paid off in January 2008.

8. Long-Term Obligations

For the year ended June 30, 2007, changes in long-term obligations were as follows:

	Purchase Note Payable	Bonds Payable	Accrued Vacation
Balances at July 1, 2006	\$ 28,600,000	\$ 9,713,362	\$ 1,337,137
Increase	-	-	593,460
Decrease	<u>(2,200,000)</u>	<u>(8,847,627)</u>	<u>(432,451)</u>
Balances at June 30, 2007	<u>\$ 26,400,000</u>	<u>\$ 865,735</u>	<u>\$ 1,498,146</u>

Obligations for accrued vacation are generally liquidated by the general fund, the Hawaiian Home Operating Fund and the Hawaiian Home Administration Account.

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9. Bonds Payable

The following are portions of the State general obligation bonds allocated to the Department under acts of various Session Laws of Hawaii. These bonds are backed by the full faith, credit and taxing power of the State. Repayments of allocated bond debts are made to the State General Fund. Details of the allocated bonds as of June 30, 2007, are as follows:

\$1,000,346 Series BW bonds dated March 1, 1992; \$166,708 was refunded on February 15, 2002 and \$112,089 was refunded on June 15, 2005; due in annual principal installments of \$55,569 commencing March 1, 2006 through March 1, 2008 and \$54,619 on March 1, 2011 and \$55,569 on March 1, 2012; interest at 5.875% to 6.40% payable semi-annually.	\$ 165,757
\$124,303 Series BZ bonds dated October 1, 1992; \$7,769 was refunded on April 1, 1998 and \$23,307 was refunded on February 15, 2002; due in annual principal installments of \$7,769 commencing October 1, 2005 through October 1, 2012; interest at 5.40% to 6.25% payable semi-annually.	38,844
\$758,726 Series CI refunding bonds dated November 1, 1993; due in annual principal installments of \$50,587 through November 1, 2003 and \$50,575 through November 1, 2010; interest at 4.00% to 5.00% payable semi-annually.	202,301
\$66,394 Series CH bonds dated November 1, 1993; \$55,335 was refunded on October 1, 1997; due in annual principal installments of \$3,689 through November 1, 2013; interest at 4.10% to 6.00% payable semi-annually.	25,817
\$86,517 Series CO bonds dated March 1, 1997; \$11,940 was refunded on April 1, 1998; due in semi-annual principal installments of \$2,257 to \$4,250 through March 1, 2011; interest at 4.50% to 6.00% payable semi-annually.	30,732
\$321,472 Series CS refunding bonds dated April 1, 1998; due in annual principal installments of \$45,740 on April 1, 2006; \$48,137 on April 1, 2007; \$50,548 on April 1, 2008 and \$53,074 on April 1, 2009; interest at 5.00% to 5.25% payable semi-annually.	103,622
\$65,992 Series CW refund bonds dated August 1, 2001; \$2,118 was refunded on June 15, 2005; due in annual principal installments of \$4,679 on August 1, 2005; \$4,873 on August 1, 2006; \$5,073 on August 1, 2007; \$5,311 on August 1, 2008; \$5,585 on August 1, 2009; \$5,885 on August 1, 2010; \$6,203 on August 1, 2011; \$6,540 on August 1, 2012; \$6,896 on August 1, 2013; \$7,273 on August 1, 2014; \$5,555 on August 1, 2015; interest at 0.82% to 0.88% payable semi-annually.	54,322
\$140,129 Series CY refunding bonds dated February 15, 2002; \$680 was refunded on June 15, 2005; due in annual principal installments of \$12,633 on February 1, 2007; \$13,217 on February 1, 2008; \$13,910 on February 1, 2009; \$14,582 on February 1, 2010; \$15,347 on February 1, 2011; \$16,192 on February 1, 2012; \$17,081 on February 1, 2013; \$18,064 on February 1, 2014 and \$19,104 on February 1, 2015; interest at 3.60% to 5.75% payable semi-annually.	126,816
Subtotal carried forward	748,211

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Subtotal brought forward	748,211
\$7,415 Series DB refunding bonds dated September 16, 2003; due in annual principal installments of \$675 on September 1, 2008; \$703 on September 1, 2009; \$738 on September 1, 2010; \$776 on September 1, 2011; \$815 on September 1, 2012; \$857 on September 1, 2013; \$902 on September 1, 2014; \$949 on September 1, 2015; and \$1,000 on September 1, 2016; interest at 5.00% to 5.25% payable semi-annually.	7,415
\$110,109 Series DG refunding bonds dated June 15, 2005; due in annual principal installments of \$9,933 on July 1, 2009; \$10,443 on July 1, 2010; \$10,978 on July 1, 2011; \$11,541 on July 1, 2012; \$12,133 on July 1, 2013; \$12,755 on July 1, 2014; \$13,409 on July 1, 2015; \$14,097 on July 1, 2016; \$14,820 on July 1, 2017; interest at 5.00% payable semi-annually.	110,109
	<u>\$ 865,735</u>

The annual requirements of the general obligation bonds are as follows:

	Interest	Principal	Total
Year ending June 30,			
2008	\$ 33,032	\$ 185,686	\$ 218,718
2009	24,241	142,446	166,687
2010	19,527	100,052	119,579
2011	15,248	157,442	172,690
2012	8,816	101,175	109,991
2013 – 2017	10,584	164,114	174,698
2018	227	14,820	15,047
	<u>\$ 111,675</u>	<u>\$ 865,735</u>	<u>\$ 977,410</u>

10. Retirement Benefits

All eligible employees of the Department are required by Chapter 88 of the Hawaii Revised Statutes to become members of the Employees' Retirement System of the State of Hawaii ("ERS"), a cost-sharing multiple-employer defined benefit public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. All contributions, benefits and eligibility requirements are established by Chapter 88, HRS, and can be amended by legislative action.

Prior to June 30, 1984, the ERS consisted only of a contributory plan. In 1984, legislation was enacted to add a new noncontributory plan for members of the ERS who are also covered under Social Security. Persons employed in positions not covered by Social Security are precluded from participating in the noncontributory plan. The noncontributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new noncontributory plan and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory plans, respectively. Contributions for employees of the Department are paid from the State General Fund.

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Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation ("AFC"). The final AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service, excluding the vacation payment.

On July 1, 2006, a hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members will receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. The benefit payment options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan will be eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006 will be required to join the hybrid plan.

Most covered employees of the contributory option are required to contribute 7.8% of their salary. The funding method used to calculate the total employer contribution requirement is the entry age normal actuarial cost method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

Actuarial valuations are prepared for the entire ERS and are not separately computed for each department or agency. Information on vested and nonvested benefits, and other aspects of the ERS, is also not available on a departmental or agency basis.

ERS issues a CAFR that includes financial statements and required supplementary information which may be obtained from the following address:

Employees' Retirement System of the State of Hawaii
201 Merchant Street, Suite 1400
Honolulu, Hawaii 96813

Post-retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State, pursuant to Chapter 87, HRS, provides certain health care and life insurance benefits to all qualified employees. For employees hired before July 1, 1996, the State pays the entire monthly health care premium for those retiring with ten or more years of credited service, and 50% of the monthly premium for those retiring with fewer than ten years of credited service. For employees hired after June 30, 1996, and retiring with fewer than ten years of service, the State makes no contributions. For those retiring with at least ten years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium; and for those retiring with over 25 years of service, the State pays the entire health care premium. Free life insurance coverage for retirees and free dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive a reimbursement for the basic medical coverage premium. Contributions are financed on a pay-as-you-go basis.

Effective July 1, 2003, the Hawaii Employer-Union Health Benefits Trust Fund ("EUTF") replaced the Hawaii Public Employees Health Fund under Act 88, SLH 2001. The EUTF was established to provide a single delivery system of health benefits to state and county employees, retirees, and their dependants.

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Deferred Compensation Plan

The State established a deferred compensation plan ("Plan") in accordance with Section 457 of the Internal Revenue Code, which enable State employees to defer a portion of their compensation. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the Plan, as well as property and rights purchased with those amounts and income attributable to these amounts are held in trust by third party agents for the exclusive benefit of participants and their beneficiaries. The assets and liabilities of the Plan are not reflected in the State of Hawaii or Department's financial statements.

11. General Leases and Licenses

The Department's general leasing operations (Section 204 of Hawaiian Homes Commission Act of 1920, as amended) consist principally of the leasing of its Hawaiian Home Lands. The general leases have varying terms extending through 2070.

The future minimum lease income from general leases as of June 30, 2007, is as follows:

Year ending June 30,	
2008	\$ 6,995,000
2009	7,133,000
2010	7,361,000
2011	7,526,000
2012	5,843,000
Thereafter	234,031,000
	<u>\$ 268,889,000</u>

12. Commitments and Contingencies

Leases

In December 2006, the Department entered into a 25-year facility lease agreement with Wells Fargo Bank, National Association (the "lessor"), to lease an office facility. As of June 30, 2007, the facility was in the process of being constructed, with an expected completion date of April 2008. Upon expiration of the lease, the title of the facility will be transferred from the lessor to the Department. The following is a schedule by years of future minimum lease payments related to this agreement:

Year ending June 30,	
2008	\$ 1,073,000
2009	1,073,000
2010	1,710,000
2011	1,714,000
2012	1,711,000
Thereafter	34,230,000
	<u>\$ 41,511,000</u>

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Litigation

The Department is a party to various legal proceedings, the outcome of which, in the opinion of management, will not have a material adverse effect on the Department's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's General Fund.

Insurance

The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2007, the State recorded an estimated loss for workers' compensation, automobile and general liability claims as long-term liabilities as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund. The Department's portion of the State's workers' compensation liability was not material at June 30, 2007.

Guaranteed and Insured Loans

As of June 30, 2007, the Department was contingently liable for approximately \$10,338,000 in loans originated primarily by the U.S. Department of Agriculture Rural Development for which the Department has guaranteed repayment. Approximately \$1,410,000 of these loans have been reported delinquent as of June 30, 2007.

The Department is also a party to a mortgage loan insurance agreement with the U.S. Department of Housing and Urban Development ("HUD"). The agreement provides that HUD will perform underwriting processing for the insurance program and will administer an insurance fund for mortgages originated and held by HUD-approved lenders. The Department will maintain and provide the necessary and proper funds for payment of any mortgage insurance claims and expenditures incurred by HUD in connection with the lessee borrowers. The Department has reserved cash of approximately \$10,850,000 in the special revenue fund and has deposited \$150,000 with HUD. As of June 30, 2007, loans outstanding totaled approximately \$310,169,000 under this agreement, of which approximately \$9,778,000 has been reported as delinquent.

As of June 30, 2007, the Department was also contingently liable for approximately \$16,630,000 in loans originated by financial institutions and other lenders for which it had guaranteed repayment. Approximately \$525,000 of these loans has been reported delinquent as of June 30, 2007.

As of June 30, 2007, the Department paid approximately \$4,764,000 for delinquent mortgage loan payments of lessees. These payments are carried as loans receivable from lessees and bear similar terms as stipulated in the lessees' mortgage notes with the lenders.

The Department has certain loans for which the collateral for the loans is not covered by casualty insurance. The number of such loans was not known as of June 30, 2007.

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Department of Hawaiian Home Lands
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Other

As of June 30, 2007, the reserve for encumbrances relating to construction contracts approximated \$140,609,000.

Pursuant to Act 14, Special SLH 1995, the Hawaiian Home Land Trust Fund was established to account for funds to be paid by the State beginning in the fiscal year ended June 30, 1996. The primary purpose of Act 14 is to resolve controversies and claims related to the Hawaiian Home Land Trust which arose between August 21, 1959 and June 30, 1988.

Act 14 requires the State to make twenty annual payments of \$30,000,000 in cash or such other consideration as agreed to between the State and the Department of Hawaiian Home Lands. Interest is determined as provided in Act 14 on the unpaid balance of any funds due, but not appropriated, by the end of each respective fiscal year. The Department received \$30,000,000 in the current year as a transfer from the Department of Budget and Finance, State of Hawaii, to the Hawaiian Home Land Trust Fund. As of June 30, 2007, the Department received approximately \$360,000,000 from the State to the Hawaiian Home Land Trust Fund.

13. Hawaiian Home Land Trust Individual Claims

In 1991, the Legislature enacted HRS Chapter 674, *Individual Claims Resolution Under the Hawaiian Home Land Trust*, which established a process for individual beneficiaries of the Hawaiian Home Lands Commission Act of 1920 to file claims to recover actual economic damages they believed they suffered from a breach of trust caused by an act or omission of an official of the State between August 21, 1959, when Hawaii became a state, and June 30, 1988.

The process was a three-step process which (1) began when informal proceedings presided over by the Hawaiian Home Land Trust Individual Claims Review Panel (the "Panel") to provide the State Legislature with non-binding findings and advisory opinions for each claim; (2) provided for the State Legislature's review and consideration of the Panel's findings and advisory opinions, and appropriations of funds to pay the actual economic damages the State Legislature deemed appropriate by October 1, 1999; and (3) allowed claimants to bring de novo civil actions by December 31, 1999 if they were not satisfied with the Panel's findings and advisory opinions, or the State Legislature's response to the Panel's recommendations.

The deadline to file a claim with the Panel was August 31, 1995. A total of 4,327 claims were filed by 2,753 individuals. As of June 2007, claims from 1,376 claimants had not been reviewed by the Panel, and all but the claims of two claimants had not been acted upon by the Legislature. In 1997, the Legislature declared it to be its intent to postpone acting upon the Panel's recommendations until all claims had been reviewed and forwarded to it.

In December 1999, three claimants filed a class action lawsuit in the First Circuit Court for declaratory and injunctive relief, and for general, special, and punitive damages under HRS Chapter 673 for the Panel's and Legislature's alleged failure to remedy their breach of trust claims under HRS Chapter 674. In August 2000, the Circuit Court entered an order granting the plaintiffs' motion for summary judgment and declaratory relief as to Count I of the Complaint, and denied the State's motions on the pleadings. The plaintiff appealed the judgment relating to the other Counts in the lawsuit with the Hawaii Supreme Court. In June 2006, the Hawaii Supreme Court affirmed the plaintiffs' right to pursue their claims under HRS Chapter 674, reversed the Circuit Court's determination that Act 14 is a settlement agreement and that the plaintiff's have a right to sue under HRS Chapter 661 and remanded the case to the Circuit Court for further proceedings. Five other claimants filed similar individual claims actions for themselves. The plaintiffs in these other

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actions have stipulated to stay all proceedings in their actions pending the resolution of all questions of law in the class action lawsuit that are common to the questions of law presented in their suits. A trial to settle these matters has been scheduled for October 2008.

Claims for actual damages under Chapter 674 are made against the State of Hawaii. Accordingly, the Department does not believe that the final settlement of the claims will have a material, adverse effect on the financial statements of the Department.

14. Assessments for Central Service and Administrative Expenses

The State of Hawaii has asserted that the Department is liable for its pro rata share of central service and administrative expenses incurred by the State in accordance with Sections 36-27 and 36-30, Hawaii Revised Statutes. Pursuant to Section 36-31, Hawaii Revised Statutes, the Department maintains that their funds are trust funds and are not subject to the special fund assessments. Accordingly, no provision for any liability has been made in the accompanying financial statements.

Effective July 1, 1998, Act 27, SLH 1998 amended Section 213 of the Hawaiian Homes Commissions Act and reclassified certain special funds as trust funds.

As of June 30, 2007, the Department's estimate of the accumulated asserted assessments since the inception of the aforementioned law approximated \$17,711,000.

15. Land Acquisition

In December 2004, the Department entered into a transfer agreement with the Housing and Community Development Corporation of Hawaii ("HCDCH"), State of Hawaii in connection with the acquisition of approximately 1,800 acres of land consisting of four properties on three islands, by the Department. A portion of the land is partially developed and is intended to be utilized for 3,500 homes for Native Hawaiians.

As part of the transfer agreement, the Department must pay \$2.2 million a year for 15 years, for a total of \$33 million, in the form of a note, to reimburse the Housing and Community Development Corporation of Hawaii, State of Hawaii, for infrastructure costs at three of the properties. This note is non-interest bearing. At June 30, 2007, the Department owed \$26,400,000 to HCDCH. The note will be repaid with monies in the Department's Hawaiian Home Land Trust Fund. The annual payment requirements of the non-interest bearing note are as follows:

Year ending June 30,	
2008	\$ 2,200,000
2009	2,200,000
2010	2,200,000
2011	2,200,000
2012	2,200,000
2013 – 2017	11,000,000
2018 – 2019	4,400,000
	<u>\$ 26,400,000</u>

Supplemental Information

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Combining Balance Sheet
Nonmajor Governmental Funds
June 30, 2007

Supplemental Information

	Hawaiian Home Loan Fund	Department of Hawaiian Home Lands Revenue Bond Special Fund	Hawaiian Home Trust	Native Hawaiian Rehabilitation Fund	Protocol Funds	Temporary Deposits	Construction Funds	Total Other Governmental Funds
Assets								
Cash and short-term investments held in State Treasury	\$ 1,402,735	\$ 9,518,621	\$ 10,850,100	\$ 10,316,976	\$ 2,147	\$ 3,632,992	\$ -	\$ 35,723,571
Receivables								
Due from State	-	-	-	-	-	-	3,937,176	3,937,176
Loans, net of allowance for losses	3,087,798	-	-	2,512	-	-	-	3,090,310
Accrued interest	-	86,160	-	94,151	-	-	-	180,311
Other assets	126,998	-	-	-	-	-	-	126,998
Total assets	\$ 4,617,531	\$ 9,604,781	\$ 10,850,100	\$ 10,413,639	\$ 2,147	\$ 3,632,992	\$ 3,937,176	\$ 43,058,366
Liabilities								
Vouchers and contracts payable	\$ 262,918	\$ -	\$ -	\$ 63,570	\$ 7	\$ -	\$ -	\$ 326,495
Other liabilities	-	-	-	-	-	3,141,795	-	3,141,795
Total liabilities	262,918	-	-	63,570	7	3,141,795	-	3,468,290
Fund Balances								
Reserved for								
Encumbrances	-	86,160	-	1,811,560	-	44,800	1,437,175	3,379,695
Receivables	3,087,798	-	-	96,664	-	-	-	3,184,462
Guaranteed and insured loans	-	-	10,850,100	-	-	-	-	10,850,100
Total reserved fund balances	3,087,798	86,160	10,850,100	1,908,224	-	44,800	1,437,175	17,414,257
Unreserved								
Special revenue funds	1,266,815	9,518,621	-	8,441,845	2,140	446,397	2,500,001	22,175,819
Total unreserved fund balances	1,266,815	9,518,621	-	8,441,845	2,140	446,397	2,500,001	22,175,819
Total fund balances	4,354,613	9,604,781	10,850,100	10,350,069	2,140	491,197	3,937,176	39,590,076
Total liabilities and fund balances	\$ 4,617,531	\$ 9,604,781	\$ 10,850,100	\$ 10,413,639	\$ 2,147	\$ 3,632,992	\$ 3,937,176	\$ 43,058,366

State of Hawaii
Department of Hawaiian Home Lands
Combining Statement of Revenues, Expenditures and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended June 30, 2007

Supplemental Information

	Hawaiian Home Loan Fund	Department of Hawaiian Home Lands Revenue	Hawaiian Home Trust	Native Hawaiian Rehabilitation Fund	Protocol Funds	Temporary Deposits	Construction Funds	Total Other Governmental Funds
Revenues								
Appropriations	\$ -	\$ -	\$ -	\$ -	-	\$ 304,316	\$ 2,500,000	\$ 2,804,316
Interest from short-term investments	-	508,676	-	450,153	5	-	-	958,834
Other	-	-	-	263,560	-	-	-	263,560
Total revenues	-	508,676	-	713,713	5	304,316	2,500,000	4,026,710
Expenditures								
Current								
Administration and support services	262,918	-	-	874,236	360	-	-	1,137,514
Homestead services	33,141	-	-	-	-	-	-	33,141
Land development	-	-	-	-	-	33,119	-	33,119
Land management	-	-	-	404	-	-	980,000	980,404
Debt service	-	8,650,000	-	-	-	-	-	8,650,000
Principal	-	320,614	-	-	-	-	-	320,614
Interest	-	-	-	-	-	-	-	-
Total expenditures	296,059	8,970,614	-	874,640	360	33,119	980,000	11,154,792
Excess (deficiency) of revenues over (under) expenditures	(296,059)	(8,461,938)	-	(160,927)	(355)	271,197	1,520,000	(7,128,082)
Other financing sources (uses)								
Transfers in	-	2,920,807	-	-	2,500	-	-	2,923,307
Transfers out	-	(4,500,000)	-	-	(500)	-	-	(4,500,500)
Total other financing sources (uses)	-	(1,579,193)	-	-	2,000	-	-	(1,577,193)
Excess (deficiency) of revenues and other financing sources over (under) expenditures and other financing uses	(296,059)	(10,041,131)	-	(160,927)	1,645	271,197	1,520,000	(8,705,275)
Fund balances at July 1, 2006	4,650,672	19,645,912	10,850,100	10,510,996	495	220,000	2,417,176	48,295,351
Fund balances at June 30, 2007	\$ 4,354,613	\$ 9,604,781	\$ 10,850,100	\$ 10,350,069	\$ 2,140	\$ 491,197	\$ 3,937,176	\$ 39,590,076

State of Hawaii
Department of Hawaiian Home Lands
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2007

Federal Program or Pass Through Entity	CFDA Number	Identifying Number	Expenditures
U.S. Department of Housing and Urban Development			
Native Hawaiian Housing Block Grant, Year 1	14.873	02NHGHI0001	\$ 830,322
Native Hawaiian Housing Block Grant, Year 2	14.873	03NHGHI0001	761,163
Native Hawaiian Housing Block Grant, Year 3	14.873	04NH4HI0001	2,109,239
Native Hawaiian Housing Block Grant, Year 4	14.873	05NH4HI0001	1,792,336
Total U.S. Department of Housing and Urban Development			<u>5,493,060</u>
U.S. Department of the Interior			
Partners for Fish and Wildlife's Humuula Koa Buffer Project	16.UNK	122002J003	<u>17,821</u>
Total U.S. Department of the Interior			<u>17,821</u>
TOTAL FEDERAL EXPENDITURES			<u>\$ 5,510,881</u>

State of Hawaii
Department of Hawaiian Home Lands
Notes to the Schedule of Expenditures of Federal Awards
June 30, 2007

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Department and is presented on the cash basis of accounting. The information on this schedule is presented in accordance with the requirements of OMB Circular A-133, *Auditing of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

2. Loans Outstanding

The Department had the following loan balances outstanding as of June 30, 2007. Loans made during the year are included in the federal expenditures presented in the schedule.

Program Title	CFDA Number	Amount Outstanding
U.S. Department of Housing and Urban Development		
Native Hawaiian Housing Block Grant	14.873	\$ 3,191,806
		<u>\$ 3,191,806</u>

State of Hawaii
Department of Hawaiian Home Lands
Notes to the Schedule of Expenditures of Federal Awards
June 30, 2007

3. Subrecipients

Of the federal expenditures presented in the schedule, the Department provided federal awards to subrecipients as follows:

Program Title/Subrecipient	CFDA No.	Amount Provided to Subrecipients
U.S. Department of Housing and Urban Development		
Native Hawaiian Housing Block Grant, Year 2		
Alu Like, Inc.	14.873	\$ 15,000
Consuelo Zobel Alger		2,637
Habitat for Humanity – Maui		50,954
Hawaii Island Community Development		103,325
Hawaiian Community Assets		97,645
Hawaiian Community Development		45,000
Habitat for Humanity – Honolulu		23,662
Menehune Development Corp.		63,563
Habitat for Humanity – Molokai		30,314
Nanakuli Housing Corporation		6,682
Papakolea Community Development		12,500
Waimanalo Hawaiian Homes Association		48,899
		<u>500,181</u>
Native Hawaiian Housing Block Grant, Year 3		
Nanakuli Housing Corporation	14.873	110,389
Kikiaola Construction Corporation		116,489
Hawaii Island Community Development		114,000
		<u>340,878</u>
Native Hawaiian Housing Block Grant, Year 4		
Council for Native Hawaiian Advancement	14.873	29,859
Habitat for Humanity – Maui		66,218
Nanakuli Housing Corporation		105,822
		<u>201,899</u>
		<u>\$ 1,042,958</u>

PART II
Government Auditing Standards

**Report of Independent Auditors on Internal Control Over Financial Reporting and
On Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance with
*Government Auditing Standards***

To the Hawaiian Homes Commission
State of Hawaii

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii, Department of Hawaiian Home Lands (the "Department") as of and for the year ended June 30, 2007, which collectively comprise the Department's basic financial statements and have issued our report thereon dated March 28, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Department's financial statements that is more than inconsequential will not be prevented or detected by the Department's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as items 07-01 and 07-02 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Department's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain other matters that we reported to management of the Department in a separate letter dated March 28, 2008.

The Department's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Department's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Department's management, the State Auditor, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Accountant LLP", with a stylized flourish at the end.

Honolulu, Hawaii
March 28, 2008

**Report of Independent Auditors on Compliance with Requirements
Applicable to Each Major Program and on Internal Control Over
Compliance in Accordance with OMB Circular A-133**

To the Hawaiian Homes Commission
State of Hawaii

Compliance

We have audited the compliance of the State of Hawaii, Department of Hawaiian Home Lands (the "Department") with the types of compliance requirements described in the U.S. Office of Management and Budget ("OMB") *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2007. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

In our opinion, the Department complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2007. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 07-03.

Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with the requirements that could have a direct and material effect on a major federal

program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over compliance.


A control deficiency in the Department's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the Department's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the Department's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

The Department's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Department's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Department's management, the State Auditor, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Acuity LLP". The signature is stylized, with the "A" and "C" being particularly prominent.

Honolulu, Hawaii
March 28, 2008

PART III
Schedule of Findings and Questioned Costs

State of Hawaii
Department of Hawaiian Home Lands
Schedule of Findings and Questioned Costs
Year Ended June 30, 2007

Section I – Summary of Auditor's Results

Financial Statements

Type of auditor's report issued Unqualified

Internal control over financial reporting

- Material weaknesses identified? yes X no
- Significant deficiencies identified that are not considered to be material weaknesses? X yes none reported

Noncompliance material to financial statements noted? yes X no

Federal Awards

Internal control over major programs

- Material weaknesses identified? yes X no
- Significant deficiencies identified that are not considered to be material weaknesses? yes X none reported

Type of auditor's report issued on compliance for major programs Unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? X yes no

Identification of major programs

CFDA Number	Name of Federal Program or Cluster
14.873	Native Hawaiian Housing Block Grant

Dollar threshold used to distinguish between type A and type B programs \$300,000

Auditee qualified as low-risk auditee? yes X no

State of Hawaii
Department of Hawaiian Home Lands
Schedule of Findings and Questioned Costs
Year Ended June 30, 2007

Section II – Financial Statement Findings

		Questioned Cost
Finding No. 07-01:	Policies and Procedures over Accounting for Capital Assets Should be Implemented (Significant Deficiency)	\$ _____
Federal Agency:	Finding is not specific to a Federal Agency	
CFDA Number and Title:	Finding is not specific to a Federal Agency	
Award Number and Award Year:	Not applicable	

Condition

The Department has not formalized any procedures regarding the reconciliation of the capital asset detail to the report received from the Department of Accounting and General Services ("DAGS"). During our current year audit, we noted the following issues related to the Department's capital assets account:

- A reconciliation of the Department's capital asset detail to the DAGS report was not performed by management;
- An unreconciled difference of \$1.4 million between the Department's capital asset detail to the DAGS report, which management was unable to reconcile without our assistance;
- Several infrastructure items totaling \$2.4 million that should have been recorded as of June 30, 2006, but were recorded in the current year;
- An infrastructure item that was recorded twice, resulting in a \$150,000 overstatement of the Department's capital asset detail.

We also noted that the Department's fiscal 2007 infrastructure rollforward schedule reflected approximately \$116 million of additions that were already recorded on the Department's June 30, 2006 financial statements. Since this amount appeared highly unusual, we examined the various assets and noted they were previously recorded as infrastructure additions in previous years.

Criteria

A reconciliation of the capital asset detail to DAGS report should be performed to ensure that all capital assets are properly recorded and accounted for in the accounting records and financial statements.

Effect

During our audit, we noted that the Department did not reconcile the capital asset detail and the DAGS report. The Department's capital assets balance is the most significant account in the Department's financial statements, and thus, any material misstatement of its capital assets balance could cause a material misstatement of the Department's financial statement. Additionally, without a reconciliation of the capital asset detail and the DAGS report, the Department would be unable to determine if there are any unrecorded or misappropriated assets.

State of Hawaii
Department of Hawaiian Home Lands
Schedule of Findings and Questioned Costs
Year Ended June 30, 2007

Cause

As the Department does not have formal written procedures to ensure the Department's capital asset detail is reconciled to the DAGS report, this important procedure was not performed by the Department.

Recommendation

We recommend that the Department implement policies and procedures to ensure that the Department reconciles the capital asset detail to the report received from DAGS and investigate and resolve any differences in a timely manner.

State of Hawaii
Department of Hawaiian Home Lands
Schedule of Findings and Questioned Costs
Year Ended June 30, 2007

		Questioned Cost
Finding No. 07-02:	Significant Audit Adjustments and Reclassifications (Significant Deficiency)	
		\$ _____
Federal Agency:	Finding is not specific to a Federal Agency	
CFDA Number and Title:	Finding is not specific to a Federal Agency	
Award Number and Award Year:	Not applicable	

Condition

During our audit, we noted that the Department did not record any prior year audit adjustments, which resulted in these adjustments being re-recorded during the current year audit. In addition, we recorded a total of 80 adjusting journal entries and 19 reclassification journal entries in the current year to ensure the financial statements were fairly stated.

Criteria

The financial statements are the responsibility of the management of the Department. Thus, the Department should take full responsibility of its financial statements by recording all adjusting journal entries and reclassification journal entries to ensure that its financial statements are accurate and reliable and to avoid having prior year entries being re-recorded each year.

Effect

If the Department continues to rely on its external auditors to post all of its prior year audit adjustments, the Department will not be capable of properly monitoring its financial position throughout the year.

Cause

The Department experienced significant turnover within its fiscal office during the year, which may have resulted in the Department's lack of qualified accounting personnel to properly record the necessary journal entries to reflect accurate financial statements. In addition, the Department has historically relied on its external auditors to record certain audit adjustments.

Recommendation

We recommend that the Department record all prior year and current year journal entries identified as part of the financial audit to ensure that the Department's financial statements are fairly stated. The Department also should reassess the qualifications of the accounting personnel to perform these responsibilities.

State of Hawaii
Department of Hawaiian Home Lands
Schedule of Findings and Questioned Costs
Year Ended June 30, 2007

Section III – Federal Award Findings and Questioned Costs

		Questioned Cost
Finding No. 07-03:	Insurance Coverage Requirement (Significant Deficiency)	\$ _____
Federal Agency:	U.S. Department of Housing and Urban Development	
CFDA Number and Title:	14.873 – Native Hawaiian Housing Block Grant	
Award Number and Award Year:	02NHGHI0001 7/1/2002 – 6/30/2003 03NHGHI0001 7/1/2003 – 6/30/2004 04NH4HI0001 7/1/2004 – 6/30/2005 05NH4HI0001 7/1/2005 – 6/30/2006	

Condition

During our audit, we noted that four out of eight loans tested did not have any evidence that the borrowers obtained adequate insurance coverage to cover the replacement cost of the housing units that were either owned, operated, or assisted with more than \$5,000 in federal funding.

Criteria

In accordance with §1006.330 of 24 CFR Part 1006 and 1007 Housing Assistance for Native Hawaiians: Native Hawaiian Housing Block Grant Program and Loan Guarantees for Native Hawaiian Housing; Interim Rule, as a condition to receiving Native Hawaiian Housing Block Grant (“NHHBG”) funds, the Department must:

- Require adequate insurance coverage for housing units that are owned, operated or assisted with more than \$5,000 of NHHBG funds, including a loan of more than \$5,000 that includes payback provisions;
- Ensure that insurance is purchased from an insurance provider or a plan of self-insurance in an amount to cover replacement cost; and
- Provide for or require insurance in adequate amounts to indemnify against loss from fire, weather, and liability claims for all housing units owned, operated or assisted by the Department.

Effect

The lack of adequate insurance coverage by the borrowers will increase the Department’s exposure to credit risk for any replacement costs of the housing units.

Cause

We reviewed the Department’s Policies and Procedures Manual and noted that there was no policy requiring the Department to obtain evidence that its borrowers maintain adequate insurance coverage for housing units that are owned, operated or assisted with more than \$5,000 in federal funding. Such policies would ensure that the loan officers comply with this requirement during the loan origination process, which would prevent loans from being approved until the proper documentation is obtained and filed.

State of Hawaii
Department of Hawaiian Home Lands
Schedule of Findings and Questioned Costs
Year Ended June 30, 2007

Recommendation

We recommend that the Department establish and implement policies and procedures to ensure that the borrowers obtain adequate insurance coverage in accordance with the compliance requirement.

State of Hawaii
Department of Hawaiian Home Lands
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2007

Section IV – Status of Prior Year Findings and Questioned Costs

Finding No. 06-01: Policies and Procedures Over Accounting for Capital Assets Should be Implemented (Significant Deficiency)

Condition

The Department has not implemented policies and procedures to properly account for its capital assets.

Criteria

Capital assets should be properly recorded and accounted for in the accounting records and financial statements.

Effect

During the prior year audit, errors in the recording of capital assets were identified, and the Department increased its July 1, 2005 capital assets balance by \$8,339,696 and increased its July 1, 2005 accumulated depreciation by \$648,456 for accumulated depreciation relating to these assets. These errors resulted in a \$7,691,240 restatement to the July 1, 2005 net assets invested in capital assets and accordingly, the Department made the necessary adjustments to its accounting records.

Cause

The errors occurred because the Department had not implemented policies and procedures to properly account for its capital assets.

Status

During the current year audit, we noted that certain procedures have been developed; however, the Department has not formalized procedures to ensure the capital asset detail is reconciled to the report received from DAGS. See current year Finding No. 07-01. This finding will not be carried forward.

State of Hawaii
Department of Hawaiian Home Lands
Status of Prior Year Findings and Questioned Costs
Year Ended June 30, 2007

Finding No. 05-01: Controls Over Accounting for Infrastructure Should be Improved
(Significant Deficiency)

Condition

The Department did not have the necessary controls to properly account for its infrastructure assets.

Criteria

Capital assets should be properly recorded and accounted for in the accounting records and financial statements.

Effect

During the prior year audit, errors in the recording of infrastructure were identified, and accordingly, the Department made the necessary adjustments to its accounting records.

Cause

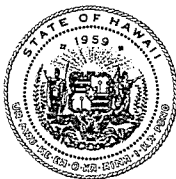
The errors occurred because the Department had not implemented policies and procedures to properly account for its capital assets.

Status

During the current year audit, we noted that certain procedures have been developed; however, the Department has not formalized procedures to ensure the capital asset detail is reconciled to the report received from DAGS. We also noted a \$1.4 million unreconciled difference in the Department's infrastructure accumulated depreciation balance between the Department's internal records and the reports received from DAGS. See current year Finding No. 07-01. This finding will not be carried forward.

Corrective Action Plan

LINDA LINGLE
GOVERNOR
STATE OF HAWAII



MICAH A. KANE
CHAIRMAN
HAWAIIAN HOMES COMMISSION

KAULANA H. PARK
DEPUTY TO THE CHAIRMAN

ROBERT J. HALL
EXECUTIVE ASSISTANT

STATE OF HAWAII
DEPARTMENT OF HAWAIIAN HOME LANDS

P.O. BOX 1879
HONOLULU, HAWAII 96805

March 25, 2008

Ms. Cindy Yee
Accuity LLP
999 Bishop Street, Suite 1900
Honolulu, HI 96813

Dear Ms. Yee:

The Department of Hawaiian Home Lands' (DHHL) Financial Audit Report, conducted by Accuity LLP, for the Fiscal Year ending on June 30, 2007, lists three findings. Below is DHHL's corrective action plan for addressing these findings.

Action Plan regarding Policies and Procedures over Accounting for Capital Assets

During the financial audit, Accuity LLP noted that reconciliation between DHHL financial records and the Department of Accounting and General Services (DAGS) report did not occur. As a result, Accuity LLP noted differences in the financial data between DHHL's records and the DAGS report, and in certain cases resulted in infrastructure items not being recorded, or recorded twice in DHHL's records.

As such, DHHL shall develop policies and procedures to review and reconcile the capital asset detail to the DAGS report, and investigate and resolve any differences.

Furthermore, DHHL proposes the following steps to account for capital assets:

1. Request that our financial auditor (Accuity LLP) transmit the detailed working paper to the DHHL Fiscal Office.
2. Fill vacant staff positions in the Fiscal Office and assign a member (or members) to focus on developing policies and procedures to review and reconcile DHHL capital assets.

3. Fiscal Officer to provide detailed instructions and criteria to the Fiscal Staff member(s) to account for DHHL capital assets.
4. Complete the capital asset reconciliation by the end of the fiscal year.
5. Inform the financial auditor to adjust the total infrastructure assets cost, if it is necessary.

Action Plan regarding Significant Audit Adjustments and Reclassifications

During the financial audit, Accuity LLP noted that DHHL did not record any prior year audit adjustments, resulting in these adjustments being re-recorded during the current year audit. In addition, Accuity LLP recorded 80 adjusting journal entries and 19 reclassification journal entries in the current year to ensure the financial statements were fairly stated.

In response, DHHL will record all prior year and current year journal entries identified as part of the financial audit to ensure that DHHL's financial statements are fairly stated.

Furthermore, DHHL proposes to take the following steps to address the suggested underlying causes which resulted in the above finding:

1. Request that our financial auditor (Accuity LLP) identify and transmit to the DHHL Fiscal Office the underlying causes and their frequency of occurrence which led to the 80 adjusting journal entries and 19 reclassification journal entries for the current year audit.
2. Request that our financial auditor (Accuity LLP) recommend a schedule or frequency for DHHL's Fiscal Office to produce financial statements and post adjusting journal entries and reclassification journal entries.
3. Fill vacant staff positions in the Fiscal Office and assign a member (or members) the responsibility of posting adjusting journal entries and reclassification journal entries to DHHL's financial statements.
4. Fiscal Officer to provide detailed instructions to the Fiscal Office member(s) for the reconciliation of DHHL's financial statements.

5. Produce and reconcile periodic financial statements.
6. Create DHHL's year-end trial balance.

Action Plan regarding Insurance Coverage Requirements

During the financial audit, Accuity LLP noted that four out of eight loans tested did not have any evidence that the borrowers obtained adequate insurance coverage to cover the replacement cost of the housing units that were either owned, operated, or assisted by DHHL with more than \$5,000 in federal funding.

In response, DHHL will revise its Housing Loan Policies and Procedures Manual to add:

1. A policy requiring DHHL to obtain evidence that its borrowers maintain adequate insurance coverage for housing units that are owned, operated or assisted by DHHL with more than \$5,000 in federal funding.
2. A procedure and checklist item requiring that such evidence be included in the loan application file before a loan is approved.

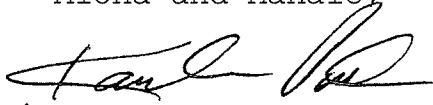
DHHL will also update its training curriculum and hold a training to remind members of DHHL's Loan Services Branch of the importance of this requirement and to orient them with the additional policy and procedures in the updated Housing Loan Policies and Procedures Manual.

Furthermore, DHHL proposes to take the following steps to minimize DHHL's exposure to credit risk for any replacement costs of the housing units:

1. Review all open loan files for housing units that are owned, operated or assisted by DHHL with more than \$5,000 in federal funding for evidence that the borrowers maintain adequate insurance coverage to cover the replacement costs of their respective housing units.
2. Send a letter to borrowers whose files lack such evidence to request a copy of such evidence for their files.
3. Request that borrowers provide DHHL's Loan Services Branch with such evidence within 30 days of receipt of the letter.

Should you have any questions about the Department's corrective action plan, please feel free to contact our Fiscal Management Officer, James Pao, at (808) 587-6404.

Aloha and Mahalo,

A handwritten signature in black ink, appearing to read "Micah Kane", written in a cursive style.

for Micah A. Kane, Chairman
Hawaiian Homes Commission